

**WORKERS' COMPENSATION ADVISORY COUNCIL**

**MINUTES ~ SEPTEMBER 23, 1999 MEETING [ 1:00 P.M.]  
710 JAMES ROBERTSON PARKWAY  
HEARING ROOM, FIRST FLOOR  
ANDREW JOHNSON TOWER  
NASHVILLE, TENNESSEE**

The meeting was called to order by Mr. Dale Sims, Treasurer's Designee.

Voting members in attendance:

Mr. Jack Gatlin  
Mr. James G. Neeley  
Mr. Bob Pitts  
Mr. Othal Smith, Jr. [by proxy to Mr. Neeley]  
Mr. Steve Turner [by proxy to Mr. Witt]  
Mr. Carter Witt

Nonvoting members in attendance:

Ms. Jacqueline B. Dixon  
Mr. Jerry Mayo

Ex officio members in attendance:

Ms. Sue Ann Head, Administrator, Workers' Compensation Division [designee for  
Michael E. Magill, Commissioner, Department of Labor and Workforce Development]  
Mr. Douglas Sizemore, Commissioner, Department of Commerce and Insurance

Also present:

M. Linda Hughes, Executive Director

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The minutes of the August 26, 1999, Workers' Compensation Advisory Council meeting were unanimously approved.

The Executive Director reviewed the statutory provisions contained in Tennessee Code Annotated §50-6-402 which establishes the process by which the Advisory Council reviews and the Commissioner of Commerce and Insurance approves, disapproves or modifies the annual advisory prospective loss costs filing by the National Council on Compensation Insurance, Inc. (NCCI). It was explained that if the Advisory Council were to recommend adoption of the current NCCI filing, the Commissioner of Commerce and Insurance could not modify the filing.

A. PRESENTATION OF WILLIS CORROON [Advanced Risk Management Services]  
RE: ANALYSIS OF NCCI ADVISORY PROSPECTIVE LOSS COSTS FILING

Mr. Gregg Alff, consulting actuary for the Advisory Council, was then introduced to present the findings of Willis Corroon's review of the NCCI loss costs filing. Mr. Alff's written report had been previously mailed to members.

Mr. Alff first stated he is in general agreement with the NCCI's calculations and the NCCI's belief that an increase in the loss costs is indicated and appropriate. Mr. Alff indicated the issues to be discussed - loss development, loss adjustment expense provision and loss costs trends are more judgmental than technical. Each issue is independently small, but when combined, they affect the outcome of the calculated loss costs level.

He then discussed different options for the Advisory Council to consider. Mr. Alff recommended consideration of stronger loss development factors than contained in the NCCI filing. In prior years the NCCI used and averaged the most recent two years of loss development in its calculations. In his review of the filing made in 1998, Mr. Alff had been critical of this method because he felt it made the factors too unstable and susceptible to wide swings because 50% weight was given to each of two factors. The NCCI responded to this criticism in the 1999 filing by using five years' average instead of two. Mr. Alff indicated in his opinion, while this lends stability to the factors, it makes the factors too unresponsive to changes in reserve levels which may be currently occurring. Mr. Alff stated the reserve level changes may require changes and increases in the loss development factors and, therefore, a three year average is a better choice as it offers a good compromise between stability and responsiveness.

Mr. Alff explained that use of a three year average will increase both the medical loss development factor and the indemnity loss development factor. He expressed concern that the latest year shows an increased development factor and that a five year average will dilute this increase too much. He stated changing to a three year average for loss development factors would increase the loss costs filing by +1%.

Mr. Alff then discussed the insurance industry's reserve patterns. In his experience, in times of intense competition, the reserves set by carriers tend to be less adequate than in other periods due to the pressure to write business but keep showing profitable results. He then distributed and discussed an exhibit taken from "Best's Aggregates and Averages - Property - Casualty, 1999".

Best's compiles statistics for the entire insurance industry taken from the financial statements of insurance companies. In Mr. Alff's opinion, the pattern of decreasing numbers in initial reserves is ending as of 1997. The initial reserves for 1998 are lower than any development for prior years' reserve ultimates. For the first time, in 1997, the initial reserves have been raised after 24 months. He stated he believed the loss reserves are less adequate today than in the early years of the decade and he believes 1998 reserves will also be developed upward in future months. This information, in his opinion, supports the conclusion that stronger loss development factors are occurring.

The loss adjustment expense component of the loss costs filing was then discussed by Mr. Alff. The issue is whether the current loss adjustment expense provision (LAE) should be changed from the current 18.1 level. The NCCI recommended the LAE provision be maintained at the 18.1 level. In Mr. Alff's opinion, the information concerning the reduction in the 1997 allocated LAE indicates a decrease in the overall loss adjustment expense would be appropriate. He suggested decreasing the LAE provision to 17.4.

Mr. Alff then discussed trend, the third element to be considered in determining the loss costs. He stated the decisions regarding the trend factor are more a matter of judgment than either the loss development factors or the loss adjustment expense. Information contained in the NCCI filing indicated indemnity loss costs in Tennessee have been declining for several years which led to the -1% indemnity trend contained in the NCCI filing. However, the initial 1998 accident year data indicate Tennessee's average indemnity claims costs are beginning to increase. This can be due to either an increase in the severity of the type of claim or an increase in the average weekly wage. In Mr. Alff's opinion, the indemnity cost containment initiatives are holding costs level, but wages are going up in Tennessee. He recommended the Advisory Council consider holding the indemnity trend at 0% instead of utilizing a negative indemnity trend as recommended by the NCCI.

With regard to medical trend, the NCCI filing contained a +2% increase. Mr. Alff suggested historical data from 1993 to present, excluding the abnormally low year of 1996, indicate medical costs per case have increased approximately +4% per year. He stated this could be due to the fact that while medical cost containment measures have been very effective in producing a very low medical trend through 1996 all the costs savings have now been realized from those initiatives and medical costs are beginning to rise again. Mr. Alff recommended utilizing a higher medical trend than the +2% contained in the NCCI filing, but not as high as +4%. He wanted the Advisory Council to be aware there is a strong possibility that medical costs are increasing faster than +2% per year and there is a very good chance that in next year's filing the trend may be +3 to +4%. He suggested utilizing a +2.5% medical trend factor, which would add +1% to the filing.

In summary, Mr. Alff suggested the Advisory Council consider a higher loss costs than the +3.3% suggested by the NCCI based on his analysis of the loss development factors and the indemnity and medical trends. He recommended an increase between +3.6% to +5.4%.

## B. COMMENTS OF THE NATIONAL COUNCIL ON COMPENSATION INSURANCE RE: LOSS COSTS FILING

Mr. Robert Blanco, actuary for the NCCI, made the presentation on its behalf. Mr. Blanco explained data from USF&G, which were not available in last year's filing, were included in the present filing for all years in which it had been unavailable.

Mr. Blanco indicated the NCCI has used a two year average in Tennessee for loss development during the past seven years. The two year average for loss development has been the NCCI's standard approach. Smaller states tend to use three to five year averages and some utilize a five year approach including elimination of the highest and lowest of the five years. The larger states generally use a two year average while medium-size states vary, depending on the data. Recently, the NCCI has observed that the two year average tends to be very volatile.

Mr. Blanco explained the NCCI filing of +3.3% is based on utilizing a five year average for loss development. They also looked at utilizing a three year average, which resulted in a +3.2% increase which is only slightly different from filed recommendation of +3.3%. Mr. Blanco indicated it was his professional judgment that for loss development it is better to give more weight to stability by utilizing a five year average than to responsiveness which would utilize a three year average.

Mr. Blanco stated historically, the NCCI has utilized an eight year average for the trend factor. As trends began to improve, there has been concern that the eight year trend is too long. In the past three years, the NCCI has utilized more types of trend factors in their analysis. With regard to indemnity trend, Mr. Blanco indicated the NCCI looked at several different types of trends to determine what trend it would include in the current filing. Utilizing an eight year trend would have resulted in -5.1% indemnity trend; other state filings averaged -1.5% indemnity trend; econometric models indicated a negative trend. Mr. Blanco stated the NCCI gave a lot of consideration to filing a 0% indemnity trend. However, they decided to continue with a negative trend because the only information pointing to indemnity trends leveling off was the preliminary 1998 accident year data and they did not want to over-react to raw data. He agreed a 0% indemnity trend is not unreasonable.

Mr. Blanco stated that after several years of decreasing medical trend, policy year 1997 medical costs are higher than policy year 1996 indicating a change in medical costs. The eight year trend would indicate a -1.5% medical trend which the NCCI did not consider a good idea. The econometric trend would indicate a slight positive trend. The average medical cost per claim in Tennessee has increased +4% per year. The NCCI felt since the 1997 medical cost data were worse than 1996 data and the 1998 accident year costs were also higher, it was prudent to raise the medical trend by +1.0% as was done in last year's filing.

With regard to loss adjustment expense, Mr. Blanco indicated countrywide data have been stable. The 1998 Tennessee specific data were unexpectedly lower than any of the past few years. The decision faced by the NCCI was whether to react to the 1998 data or to take a wait and see

attitude. The NCCI elected to take the conservative approach in the filing by recommending no change in the loss adjustment expense.

#### C. COMMENTS OF DEPARTMENT OF COMMERCE AND INSURANCE CONSULTING ACTUARY RE: LOSS COSTS FILING

The Department of Commerce and Insurance presented each Advisory Council member with a copy of the report of its consulting actuary, Casualty Actuarial Consultants, Inc. (CACI). Mr. Edward Costner, president of CACI, was recognized to present his opinions and conclusions concerning the loss costs filing.

Mr. Costner began by stating that the NCCI has a very difficult job because they are using loss data from 1996 and 1997 policy periods to forecast losses which will occur in 2001. In last year's filing, the policy periods of 1995 and 1996 were used as the data. The 1995 policy period indicated a -4.0% decrease and the 1996 policy period indicated a -19.0% decrease. Had the NCCI known then what they know now about 1996, according to Mr. Costner's calculations, instead of -19% it would have been -6.5%, assuming 1995 data remained the same. In his opinion, the 1996 decrease of 15% from the prior year appears now to have been a mirage.

Mr. Costner indicated it is the opinion of CACI that the accident year loss ratios, including loss adjustment expenses, can be affected by adjustments in the reserves. He stated it is CACI's belief that the increasing loss ratios of the late 1990's indicate the industry is entering an unprofitable period which will result in more development on the claims than has been seen historically. It is CACI's belief that the development in the middle 1990's during the very profitable period is not going to be indicative of the loss development which will be seen at the end of the 1990's. CACI has recommended an increase in the indemnity and medical loss development factors higher than that contained in the NCCI filing. Utilizing the CACI recommendations would increase the loss costs filing to +5.2%, before including the trend factors.

According to Mr. Costner, the NCCI's countrywide data indicates during the 1980's the indemnity trend in the United States was +8.0% per year and the medical trend was +12% per year. All of the trend changed in approximately 1990. Countrywide, the medical trend in the 1990's has been +4.0% and the indemnity trend has been basically 0%, if not a slightly negative number. CACI is concerned that the increase in the trend shown in the preliminary 1998 accident year data does indicate the trends are changing. Mr. Costner stated if the indemnity trend is increased to unity and the indemnity and medical loss development factors are increased as recommended by CACI, the indication is for a +7.1% increase in the loss costs.

Mr. Costner then indicated it is the opinion of CACI that there are significant reasons for the selection of an increase in the loss costs factors to support an increase of more than the +3.3% recommended by the NCCI. He stated his opinion that it would not be the end of the world if the loss costs are not increased by +7.0% or +10.0% because the insurance industry does have the

opportunity to charge whatever loss costs multipliers or discounts it wishes. In his opinion a greater increase would send a message that the level of premiums need to rise in order to prevent some insurance companies from experiencing problems without recognizing it. Mr. Costner then indicated CACI truly feels an increase of between +5.0% and +7.0% would be more indicative of where the loss costs need to be. He also stated it is possible the trend in costs may be beyond that into double digits.

#### D. ADVISORY COUNCIL CONSIDERATION OF LOSS COST FILING

The Advisory Council members then discussed the presentations and the various factors affecting the loss costs evaluation.

Mr. Witt stated his concern that a true picture of the industry is not being revealed due to the manner in which the insurance companies are utilizing the multiplier factor resulting in an inability to determine a true and accurate expense factor. He remarked he had hoped when the loss costs method was enacted that it would result in a standard system which would easily display the true costs of the losses and expenses. He noted he sees no system by which the multipliers would work as intended. He urged action by the Advisory Council which would not keep the loss costs suppressed in an effort to try to force changes in the selection and application of the individual company multipliers.

Mr. Mayo commented that he agreed the market is turning and that a higher loss costs than filed by the NCCI is warranted at this point. Mr. Neeley remarked the information concerning a rising medical trend factor in Tennessee is of concern to him because despite all the reforms to the Tennessee workers' compensation system, control of medical costs has not resulted. He stated this is an issue to be analyzed. Mr. Neeley also commented that he did not want the Advisory Council to make a recommendation which would tie the hands of the Commissioner of Commerce and Insurance.

Mr. Pitts stated he felt the Advisory Council should do as had it had done in 1998 and recommend a greater increase than requested by the NCCI. He indicated his opinion is based on a belief that the operating ratios for workers' compensation have moved above, or very close to, 100% and the universal agreement that reserves have been pulled down making the range of operation more restrictive. He then made a motion that the Advisory Council recommend an increase of +7.0%, which is slightly higher than the average of the consulting actuaries' recommendations. Mr. Pitts expressed that it is the duty of the Advisory Council to put out the best data possible and that he is of the opinion since there is unanimity the market is turning. He stated it is now incumbent on the insurance industry, when selecting multipliers, to make certain to produce sufficient premium to assure claims can be paid. He recommended action by the Advisory Council which might prevent a double digit loss costs increase next year.

Mr. Witt seconded the motion made by Mr. Pitts, with the additional recommendation that the loss adjustment expense component remain the same as the current factor. The motion, as amended, [to recommend a +7% increase in the advisory prospective loss costs with no change in the loss adjustment expense component] was unanimously adopted by the voting members of the Advisory Council.

E. EXECUTIVE DIRECTOR REPORT

Ms. Hughes noted the budget report for the third quarter was contained in each member's packet of materials and that the Advisory Council is within its budget. She reminded the Advisory Council the next meeting would be Tuesday, November 9, 1999 at 10:00 a.m. at the same location.

The meeting was adjourned at 3:20 p.m., without objection.